No. 75-578

In the Supreme Court of the United States

OCTOBER TERM, 1975

PAUL S. MOLONEY AND ROSMAN GREUBEL, EXECUTOR OF THE ESTATE OF DORA M. MOLONEY, PETITIONERS

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

MEMORANDUM FOR THE UNITED STATES IN OPPOSITION

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This tax refund suit arises from a deficiency assessment, which petitioners claimed, *inter alia,* was invalid because it followed a second examination of their books, without notice, in contravention of the limitations of Section 3631 of the Internal Revenue Code of 1939.[1]

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[1]Section 3631 of the 1939 Code (predecessor of Section 7605(b) of the 1954 Code) provides:

> SEC. 3631. RESTRICTIONS ON EXAMINATION OF TAXPAYERS.
>
> No taxpayer shall be subjected to unnecessary examinations or investigations, and only one inspection of a taxpayer's books of account shall be made for each taxable year unless the taxpayer requests otherwise or unless the Commissioner, after investigation, notifies the taxpayer in writing that an additional inspection is necessary.

Although the district court upheld petitioners' contention that the second examination was prohibited by Section 3631, the court of appeals reversed (Pet. App. 24a-28a).[2]

1. The court of appeals correctly held that an unauthorized second examination of a taxpayer's books and records under Section 3631 of the 1939 Code (predecessor of Section 7605(b) of the 1954 Code) does not automatically invalidate a tax assessment. Both the district court and the court of appeals noted that Section 3631 does not contain any sanctions for its violation.[3] Moreover, as the court of appeals pointed out (Pet. App. 26a), the courts have held that generally re-inspection is not a bar to the assessment where, as here, the taxpayer fails to object, or voluntarily consents. See, *Field Enterprises, Inc.* v. *United States,* 348 F.2d 485 (Ct. Cl.); *Rife* v. *Commissioner,* 41 T.C. 732; *Philip Mangone Co.* v. *United States,* 54 F.2d 168 (Ct. Cl.); *Estate of Barker* v. *Commissioner,* 13 B.T.A. 562; *McDonnell* v.

[2]The court of appeals also reversed the district court's decision on the merits, holding that a stock redemption, pursuant to the reduction in the stated capital of petitioners' wholly-owned corporation (The Moloney Corporation), was essentially equivalent to the distribution of a taxable dividend under Section 115(g) of the 1939 Code. Petitioners do not challenge this determination on the merits. Moreover, the court of appeals, having determined the merits of the petitioners' claim for refund in favor of the government, did not reach the additional question whether the greater part of petitioners' claim was barred by the statute of limitations (Pet. App. 28a).

[3]The legislative history of this provision indicates that Congress intended it to prevent the Internal Revenue Service from undertaking repetitive investigations as a method of taxpayer harassment. However, nothing in the committee reports suggests that it was enacted to restrict the scope of the Commissioner's power to protect the revenue. H.R. Rep. No. 350, 67th Cong., 1st Sess., p. 16 (1921); S. Rep. No. 275, 67th Cong., 1st Sess., pp. 20-21 (1921); H.R. Conf. Rep. No. 356, 69th Cong., 1st Sess., p. 55 (1926). See *United States* v. *Powell,* 379 U.S. 48, 54-55.

Commissioner, 6 B.T.A. 685.[4] Indeed, as the court of appeals pointed out (Pet. App. 28a), petitioner Paul Moloney knew the second examination was being conducted and failed to object to it.

Reineman v. *United States,* 301 F.2d 267 (C.A. 7), is not to the contrary. In *Reineman,* the court set aside an assessment against the taxpayer, relying principally upon the facts that: (1) an unauthorized second examination of the taxpayers' books took place without their knowledge, so that they had no opportunity to oppose; and (2) the information used to determine the deficiency was not available to the Commissioner, except from the second examination of the taxpayers' books and records. But as the court below correctly pointed out (Pet. App. 27a), *Reineman* did not create an automatic rule invalidating an assessment every time there is a violation of the second inspection rule. Indeed, in *Reineman,* the court distinguished *Philip Mangone Co.* v. *United States, supra, Estate of Barker* v. *Commissioner, supra,* and *McDonnell* v. *Commissioner, supra,* noting that under such circumstances, "the courts have properly held that taxpayers have waived their rights under the statute" (301 F.2d at 272). Thus, the court of appeals properly ruled that not every infraction of the notice requirement calls for nullification of the deficiency assessment.

[4]These cases indicate that the general remedy for a violation of this provision is that the taxpayer may refuse to permit the subsequent examination, and may oppose the Internal Revenue Service's application for enforcement of the subpoena. See in particular, *Field Enterprises, Inc.* v. *United States, supra; Philip Mangone Co.* v. *United States, supra; Estate of Barker* v. *Commissioner, supra; McDonnell* v. *Commissioner, supra.* Thus, contrary to the district court's assumption (Pet. App. 8a), the interpretation adopted by the court below, and by the courts generally, does not render the statute "completely meaningless."

2. Furthermore, the court of appeals correctly concluded that while the radical remedy of invalidation of the assessment may be appropriate in certain circumstances,[5] it was not appropriate here, where, for the most part, the assessment was not based upon the examination of petitioners' partnership or personal records, but instead upon the non-privileged corporate records (*i.e.*, the company's balance sheets and the corporate resolution) and the relevant tax returns (Pet. App. 28a). Unlike the taxpayers in *Reineman*, petitioner Paul Moloney was aware of the examination at the time it took place and failed to object to it (Pet. App. 28a).

For the reasons stated, it is respectfully submitted that the petition for a writ of certiorari should be denied.

ROBERT H. BORK,
Solicitor General.

NOVEMBER 1975.

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[5]In addition to *Reineman* v. *United States*, *supra*, see *Application of Leonardo*, 208 F. Supp. 124 (N.D. Cal.), where the court suppressed the use of evidence, allegedly obtained in violation of Section 7605(b) of the 1954 Code, as the basis for criminal prosecution.

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